

South Macomb Disposal Authority

Financial Report

June 30, 2003

South Macomb Disposal Authority

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Independent Auditor's Report

To the Board of Directors
South Macomb Disposal Authority

We have audited the accompanying basic financial statements of South Macomb Disposal Authority as of June 30, 2003 and for the year then ended, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Macomb Disposal Authority at June 30, 2003 and the results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis (identified in the table of contents) is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

As described in Note I, Southeast Macomb Disposal Authority has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and related statements, as of July 1, 2002.

Plante & Moran, PLLC

September 26, 2003

South Macomb Disposal Authority

Management's Discussion and Analysis

Using this Annual Report

South Macomb Disposal Authority (the "Authority") is a joint venture of five cities located in southern Macomb County: Centerline, Eastpointe, Roseville, St. Clair Shores, and Warren. The primary roles of the Authority are to manage the transfer of solid waste currently collected by all of the member cities (except Warren) and to provide for the postclosure care of landfill sites previously operated by the Authority. The Authority does not operate any landfill sites currently. This annual report consists of a series of financial statements. The statement of net assets and the statement of revenue, expenses, and changes in net assets provide information about the financial activities of the Authority. This is followed by the statement of cash flows, which presents detailed information about the changes in the Authority's cash position during the year.

Financial Overview

In analyzing the Authority's financial position, it is important to recognize the dual missions of the Authority. From a financial perspective, the Authority's core objective (and ongoing operation) is to manage the costs of solid waste transfer for Centerline, Eastpointe, Roseville, and St. Clair Shores. With respect to this core objective, the Authority acts as a conduit for the four participating members. The amounts to be charged to the participating members for these services will, by definition, be equal to the Authority's costs of providing solid waste transfer services. The key financial statistics for the Authority, therefore, relate to measurements of the ability to reduce total costs to its members (as opposed to the ability to accumulate financial resources). To this end, the net assets of the Authority related to ongoing operations approximates \$1,700,000, of which approximately \$980,000 is invested in capital assets.

The other objective of the Authority is to provide for the postclosure care of landfill sites previously operated by the Authority, including all five of its member cities. There are four such sites as of June 30, 2003. Pursuant to the postclosure care, and ultimate remediation, of another site for which the Authority no longer has any responsibility, the Authority has successfully sued its insurers and received a settlement that releases the liability of the insurers for remediation of any of the remaining four sites. The Authority also has received grant monies from the State of Michigan related to the remediation. To the extent that the settlement with the insurers is deemed to be a recovery of costs paid with grant monies, the Authority will be required to reimburse the State of Michigan. As of June 30, 2003, the Authority has net assets of approximately \$13,700,000 accumulated to pay future postclosure care or remediation costs, of which the State of Michigan may require reimbursement of approximately \$5,100,000. In addition, with respect to two of the four remaining landfill sites, the Authority has been notified by regulatory authorities of possible remediation. Preliminary estimates of the total cost of such remediation are as much as \$16,000,000. Based on current information available regarding the sites in question, the Authority is unable to determine the actual total cost of the remediation or its portion of the liability to pay for the remediation.

South Macomb Disposal Authority

Management's Discussion and Analysis (Continued)

Condensed Financial Information

The following table presents condensed information about the Authority's financial position compared to the prior year.

	Year Ended June 30		Change	
	2003	2002	Amount	Percent
Current assets	\$ 14,547,106	\$ 9,830,170	\$ 4,716,936	48%
Capital assets	2,005,745	2,048,487	(42,742)	(2%)
Noncurrent assets	-	20,031,000	(20,031,000)	(100%)
Total assets	16,552,851	31,909,657	(15,356,806)	(48%)
Current liabilities	908,360	800,625	107,735	13%
Long-term liabilities	3,269,253	20,511,604	(17,242,351)	(84%)
Total liabilities	4,177,613	21,312,229	(17,134,616)	(80%)
Net Assets:				
Invested in capital assets	2,005,745	2,048,487	(42,742)	n/a
Unrestricted	10,369,493	8,548,941	1,820,552	21%
Total net assets	\$ 12,375,238	\$ 10,597,428	\$ 1,777,810	n/a

The following table presents condensed information about the Authority's revenues and expenses compared to the prior year.

	Year Ended June 30		Change	
	2003	2002	Amount	Percent
Disposal fees	\$ 1,997,118	\$ 2,715,882	\$ (718,764)	(26%)
Administrative fees	63,764	72,419	(8,655)	(12%)
Total operating revenue	2,060,882	2,788,301	(727,419)	(26%)
Operations and maintenance	87,636	176,773	(89,137)	(50%)
General and administrative	18,184	58,890	(40,706)	(69%)
Contracted disposal costs	1,787,517	2,471,444	(683,927)	(28%)
Total operating expenses	1,893,337	2,707,107	(813,770)	(30%)
Postclosure and remediation costs	(3,032,505)	-	(3,032,505)	n/a
Site 9/9A lawsuit settlement	23,152,108	-	23,152,108	n/a
Municipal landfill cost-share grant	3,455,728	1,512,367	1,943,361	128%
Other income	871,038	1,558,518	(687,480)	(44%)
Lawsuit expenses	(154,943)	(316,995)	162,052	(51%)
Interest expense	(522,947)	(1,246,495)	723,548	(58%)
Forgiveness of assessment receivable	(20,000,000)	-	(20,000,000)	n/a
Cost of defeasement of bond	(2,158,214)	-	(2,158,214)	n/a
Other expense	-	21,817	(21,817)	(100%)
Total nonoperating revenue	1,610,265	1,529,212	81,053	5%
Net income	\$ 1,777,810	\$ 1,610,406	\$ 167,404	

South Macomb Disposal Authority

Management's Discussion and Analysis (Continued)

Significant Variances from Prior Year

Significant variances in the Authority's revenue and expenses from the prior year resulted primarily from a \$23,000,000 settlement received from the Authority's insurers (separate from contingent fees collected by legal counsel from the insurers), the subsequent use of proceeds to defease \$20,000,000 in bonds, and the forgiveness by the Authority of special assessments to the member cities for payment of the defeased debt.

The increase in net assets from the prior year resulted from the aforementioned legal settlement and grant reimbursement awards related to the Authority's landfill site postclosure care activities.

Net Asset Designations and Risk Management

The Authority has potentially significant economic issues to resolve over the next several years related to four landfill sites. The accumulated net assets for postclosure care costs have been set aside by the Authority's governing body to serve as a reserve fund for potential remediation costs for which the Authority is now uninsured and for additional grant refunds that the State of Michigan may require of the Authority.

Economic Factors and Next Year's Budget

For ongoing solid waste transfer operations, costs will be dependent on the volume of solid waste hauled. The Authority's budget for the year ending September 30, 2003 forecasts a moderate increase in solid waste and, therefore, costs.

The Authority has estimated and recorded known postclosure care liabilities as of June 30, 2003. The Authority will amend its budget as necessary for additional costs assessed by the State of Michigan or other regulatory authorities.

Contacting the Authority's Management

This financial report is intended to provide our member cities with a general overview of the Authority's finances and to show the Authority's accountability for the money it receives from the member cities and other sources. If you have questions about this report or need additional information, we welcome you to contact the Authority offices.

South Macomb Disposal Authority

Statement of Net Assets June 30, 2003

Assets

Cash and investments (Note 2)	\$ 14,174,051
Accounts receivable	334,757
Accrued interest receivable	30,016
Prepaid insurance	8,282
Capital assets (Note 3)	<u>2,005,745</u>

Total assets 16,552,851

Liabilities

Accounts payable	878,360
Accrued postclosure care liabilities:	
Due within one year	30,000
Due in more than one year	<u>3,269,253</u>

Total liabilities 4,177,613

Net Assets

Invested in capital assets	2,005,745
Unrestricted (Note 5)	<u>10,369,493</u>

Total net assets \$ 12,375,238

South Macomb Disposal Authority

Statement of Revenue, Expenses, and Changes in Net Assets Year Ended June 30, 2003

Operating Revenue

Disposal fees	\$ 1,982,820
Closure cost billings	14,298
Administrative fees	<u>63,764</u>

Total operating revenue 2,060,882

Operating Expenses

Operations and maintenance	87,636
General and administrative	18,184
Contracted disposal costs	<u>1,787,517</u>

Total operating expenses 1,893,337

Operating Income 167,545

Nonoperating Revenue (Expenses)

Post-closure and remediation costs	(3,032,505)
Site 9/9A lawsuit settlement (Note 4)	23,152,108
Municipal landfill cost share grant	3,455,728
Special assessment interest income	530,854
Investment interest income	252,184
Gain on sale of land	88,000
Lawsuit expenses	(154,943)
Interest expense	(522,947)
Forgiveness of assessment receivable (Note 4)	(20,000,000)
Cost of defeasement of bond (Note 4)	<u>(2,158,214)</u>

Total nonoperating revenue 1,610,265

Net Income 1,777,810

Net Assets - Beginning of the year 10,597,428

Net Assets - End of the year \$ 12,375,238

South Macomb Disposal Authority

Statement of Cash Flows Year Ended June 30, 2003

Cash Flows from Operating Activities

Cash received from customers	\$ 2,265,252
Cash payments to suppliers for goods and services	<u>(1,592,408)</u>
Net cash provided by operating activities	672,844

Cash Flows from Noncapital Financing Activities

Bond interest expense	(522,947)
Interest received on special assessments	530,854
Payment of postclosure care costs	(394,309)
Cash received from State agency	3,455,728
Cost of defeasement of debt	(22,158,214)
Cash received from lawsuit settlement - Net of related legal expenditures (Note 4)	<u>22,997,165</u>
Net cash provided by noncapital financing activities	3,908,277

Cash Flows from Investing Activities

Proceeds from sale of land	88,000
Interest received on investments	304,636
Purchase of investments	<u>(2,891,634)</u>
Net cash used in investing activities	<u>(2,498,998)</u>

Net Increase in Cash and Cash Equivalents

2,082,123

Cash and Cash Equivalents - July 1, 2002

7,671,663

Cash and Cash Equivalents - June 30, 2003

\$ 9,753,786

Balance Sheet Classification of Cash and Cash Equivalents

Cash and investments	\$ 14,174,051
Investments greater than 90 days	<u>(4,420,265)</u>
Total cash and cash equivalents	<u>\$ 9,753,786</u>

Cash Flows from Operating Activities

Operating income	\$ 167,545
Adjustments to reconcile operating income to net cash from operating activities:	
Depreciation and amortization	42,742
Changes in assets and liabilities:	
Decrease in accounts receivable	287,822
Increase in accounts payable	<u>174,735</u>
Net cash provided by operating activities	<u>\$ 672,844</u>

Supplemental Cash Flow Information - Significant noncash noncapital financing activities consisted of the forgiveness of \$20,000,000 of special assessment receivables from the member cities and accrual of postclosure care liabilities of \$2,518,611.

South Macomb Disposal Authority

Notes to Financial Statements June 30, 2003

Note 1 - Nature of Business and Significant Accounting Policies

The South Macomb Disposal Authority (the "Authority") consists of five member municipalities in Macomb County, Michigan. The Authority currently provides refuse disposal services primarily for the benefit of four of the five member municipalities. The governing body of the Authority consists of five members - one appointed by each of the five member communities.

The accounting policies of the Authority conform to generally accepted accounting principles as applicable to an enterprise fund of a governmental unit. Accordingly, the accrual basis of accounting is followed by the Authority. In accordance with generally accepted accounting principles, there are no component units to be included in these financial statements.

Fixed Assets - Fixed assets are recorded at cost and are shown net of accumulated depreciation. Depreciation is computed using the straight-line method.

Cash Equivalents - For purposes of the statement of cash flows, the Authority considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Investments - Investments are valued at fair value.

Other accounting policies are disclosed in other notes to the financial statements.

Accounting Changes

GASB Statement No. 34 - Effective July 1, 2002, Southeast Macomb Disposal Authority implemented the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* (GASB No. 34).

Note 2 - Deposits and Investments

The Authority's deposits and investments, which are categorized on the balance sheet as cash and investments, are composed of the following:

Bank deposits (checking accounts, savings accounts, money market accounts, and certificates of deposit)	\$ 14,174,001
Petty cash	<u>50</u>
Total	<u>\$ 14,174,051</u>

South Macomb Disposal Authority

Notes to Financial Statements June 30, 2003

Note 2 - Deposits and Investments (Continued)

Deposits

Deposits were reflected in the accounts of the bank (without recognition of checks written but not yet cleared or of deposits in transit) at approximately \$14,000,000 at June 30, 2003. Of that amount, \$400,000 was covered by federal depository insurance and the remainder was uninsured and uncollateralized.

The Authority believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. As a result, the Authority evaluates each financial institution with which it deposits Authority funds and assesses the level of risk of each institution. Only those institutions with an acceptable estimated risk level are used as depositories.

Note 3 - Capital Assets

Capital asset activity for the year ended June 30, 2003 was as follows:

	2002	Deductions	2003	Depreciable Life - Years
Capital assets not being depreciated -				
Land	\$ 1,139,648	\$ -	\$ 1,139,648	-
Capital assets being depreciated:				
Site improvements	585,144	-	585,144	40
Equipment	346,848	-	346,848	7-15
Waste transfer station	1,201,645	-	1,201,645	40
Transfer station equipment	36,807	-	36,807	10-15
Subtotal	2,170,444	-	2,170,444	
Less accumulated depreciation for:				
Site improvements	(197,579)	(14,800)	(212,379)	
Equipment	(339,824)	(3,425)	(343,249)	
Waste transfer station	(687,395)	(24,517)	(711,912)	
Transfer station equipment	(36,807)	-	(36,807)	
Subtotal	(1,261,605)	(42,742)	(1,304,347)	
Net capital assets being depreciated	908,839	(42,742)	866,097	
Total capital assets - Net of depreciation	<u>\$ 2,048,487</u>	<u>\$ (42,742)</u>	<u>\$ 2,005,745</u>	

South Macomb Disposal Authority

Notes to Financial Statements June 30, 2003

Note 4 - Defeasance of Debt

During the year ended June 30, 2003, the Authority received net proceeds of approximately \$23,000,000 in litigation settlement from the insurers to recover defense costs, private plaintiff claims, and remediation costs that it incurred related to a landfill site formerly operated by the Authority. The Authority used \$21,986,176 of the proceeds to defease \$20,000,000 of revenue bonds issued in December 2000, the proceeds of which were used to pay for the remediation and related costs and claims. The Authority concurrently relieved its member communities of their obligation to repay these bonds and forgave assessment receivables from the member communities totaling \$20,000,000.

Pursuant to the defeasance, securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the revenue bonds. As a result, the bonds are considered to be defeased and the liability for the bonds has been removed from the Authority's balance sheet.

Note 5 - Net Assets

The Authority has designated certain net assets related to postclosure care and potential remediation activities. The designated net assets include State of Michigan grant monies and proceeds from several litigation settlements with the Authority's insurers for remediation of one of the Authority's landfill sites. As part of these settlements, the insurers may be held to pay future defense costs but not remediation costs for the other sites operated by the Authority. The amount of net assets designated totals \$13,737,687 which includes a portion of the capital assets of the Authority. The Authority has designated these funds in a postclosure care/insurance reserve fund to pay for the potential refund of grant monies or remediation of other landfill sites (see Note 8).

Note 6 - Risk Management

The Authority is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The Authority has purchased commercial insurance for medical and life insurance claims, and participates in the Michigan Municipal League risk pool for claims relating to property loss, torts, errors and omissions, and employee injuries (workers' compensation). Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

South Macomb Disposal Authority

Notes to Financial Statements June 30, 2003

Note 6 - Risk Management (Continued)

The Michigan Municipal League risk pool program operates as a common risk-sharing management program for local units of government in Michigan; member premiums are used to purchase commercial excess insurance coverage and to pay member claims in excess of deductible amounts.

Note 7 - Postclosure Care Liabilities

Current State and federal laws and regulations require final covers on active landfill sites and the performance of certain maintenance and monitoring functions at the site for 30 years after closure. Although closure and postclosure care costs are paid only near or after the date that the landfill stopped accepting waste, the Authority reports a portion of these closure and postclosure care costs as an operating expense in each period based on landfill capacity used as of each balance sheet date. As of June 30, 2003, the Authority has four landfill sites for which it has continuing postclosure maintenance and monitoring responsibilities.

The Authority has also recorded a liability for landfill postclosure care for all sites at June 30, 2003. This amount is an estimate of the cost to perform all known postclosure care in current dollars for all other Authority landfill sites with continuing maintenance requirements. Actual cost may be higher due to inflation, changes in technology, or changes in regulations.

Note 8 - Contingent Liabilities

The Authority has been notified by the State of Michigan Department of Environmental Quality (MDEQ) of its liability for the possible remediation of two landfill sites previously operated by the Authority. The Authority has received preliminary estimates of the cost of the remediation, including performance of a comprehensive engineering study, that estimate the liability could be as high as \$16,000,000. However, no agreement has been reached with MDEQ and, as such, the Authority is unable to conclude regarding the adequacy of the remediation plans contemplated in the preliminary estimates. Additionally, the Authority believes it has strong defenses limiting its share of responsibility, and that of its member communities, for the cost of the remediation. Pursuant to past settlements with its insurers to cover the remediation of another landfill site (Site 9/9a), the Authority is not insured for any future remediation liabilities. The Authority's total liability for cost of the remediation of the two sites in question is unknown as of June 30, 2003.

South Macomb Disposal Authority

Notes to Financial Statements June 30, 2003

Note 8 - Contingent Liabilities (Continued)

In addition, the Authority has received a total of \$5,716,911 in landfill grant funds from the State of Michigan to assist with the remediation of Site 9/9a. The State contends that, pursuant to the landfill grant statute, all of these funds should be returned to the State since the Authority received reimbursement from its insurers. The Authority disputes the State's contention, claiming that a portion of the settlements received from its insurers were reimbursements of costs that were not included in the basis for the grant funds received and thus should not be included in the repayment formula. The Authority has recorded a liability of approximately \$600,000 based on its own calculation of its repayment obligation pending review and determination of the required reimbursement by the Brownfield Review Board

Note 9 - Postemployment Benefits

The Authority provides health care benefits to all full-time employees upon retirement. Currently, three retirees are receiving benefits. The Authority includes retirees and their dependents in its insured health care plan, with no contribution required by the participants. Expenditures for postemployment health care benefits are recognized as insurance premiums become due; during the year, this amount was approximately \$6,000.